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JAPANESE BANKS IN THE UNITED STATES

Summary

Japanese banks, the world's largest if measured by assets, have established an international presence. They steadily expanded their activities in the United States during the 1980s and by the same measure are easily the largest foreign presence in this country's banking market. The asset yardstick exaggerates both their global preeminence and their U.S. position, but few experts would deny the important role of Japanese banks in this country's financial structure.

Competition across an ever broader range of financial services, such as offering credit guarantees or helping finance leveraged buyouts, has created cost savings for U.S. firms and state and local governments, especially local authorities that have solicited business from Japanese banks. These new activities -- plus expanded loan and deposit-taking businesses -- have widened the influence of Japanese banks in U.S. financial markets.

Even though few individual Americans have personal experience with Japanese banks, U.S. politicians are paying close attention to their growth. This intense scrutiny suggests the possibility of new restrictions. For this and other reasons Japanese bank activity may grow relatively slowly in the United States during the early 1990s.

Japanese Banks in the World Economy

Japanese banks' rapid rise to the top ranks among all the world's banks is well documented, as is the relative decline of U.S. banks. An American

Banker survey that listed banks worldwide on the basis of assets as of December 31, 1988 showed Japanese institutions monopolizing the top 10 spots; Dai-Ichi Kangyo Bank, Ltd. topped the lot with $386.9 billion in assets. Twenty years ago American banks held most of the top 10 spots, according to comparable studies. In the American Banker study the largest U.S. bank, Citibank NA, ranked 24th, with 17 Japanese banks ahead of it. DKB on this basis was more than twice the size of Citibank.

Other comparisons are slightly more favorable to U.S. banks. When bank companies, rather than the individual banks themselves, are ranked by assets, Citicorp, which includes many entities other than Citibank, rises to 12th place. DKB retains its number-one ranking at nearly twice Citicorp's size. Even on this basis, however, Citicorp is the lone American institution among the world's 25 largest banking companies, which includes 17 concerns from Japan.[1]

Yet Citicorp and other American banks continue to enjoy the respect of their Japanese rivals. Other considerations explain why this is so. U.S. banks have a much higher proportion of their banking business in activities that do not generate assets on balance sheets. For example, Citicorp is active in arranging leveraged buyouts but ends up holding few of the resultant loans or bonds generated by such activity. Its role as organizer, however, results in fees large enough at times to dwarf the amount of interest earned by the institutions that actually provide the LBO funding. For this reason many experts believe that rankings based on assets alone are seriously flawed; they have proposed other measurements.

The Banker, a British publication, for example, changed its yardstick in its most recent survey. It ranked the world's banks according to the size of their primary capital, a concept roughly equal to funds paid into the bank by stockholders and accumulated over the years by the bank through retained earnings. (This measure corresponds closely to so-called Tier 1 capital as defined by the Bank for International Settlements for purposes of measuring capital adequacy. Capital adequacy ratios are discussed below.) This measure changes relative sizes dramatically. Two British banks, National Westminster Bank PLC and Barclays Bank PLC, claim the top two spots. Citicorp edges out Fuji Bank, Ltd. for third place, with $9.9 billion in capital compared to the Japanese institution's $9 billion. Japanese banks claim six of the top 10 places (DKB ranks seventh) and 10 of the top 20. Among American banks other than Citicorp, only J.P. Morgan Corp., which ranks 19th on this basis, cracks the top 20.

The Banker also provides employment data. On this basis the two British banks again finish just ahead of Citicorp, which has 89,000 employees, 4.8 times as many as DKB, Japan's largest. In fact, at least eight American banks have more employees worldwide than the biggest Japanese institution.[2]

[1] American Banker, July 25, 1989, pp. 23 and 32.

[2] The Banker, July 1989, p. 54.

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All the measures presented so far combine the domestic and the international activities of the banks in question. For the purpose of considering Japanese banking activity in the United States, international assets are the relevant statistic. According to the Bank for International Settlements, Japanese-owned banks had foreign assets of $1.8 trillion at the end of 1988, more than double the figure for banks headquartered in the United States, the runner-up. An estimated quarter of these assets and Japanese bank branches are located in the United States, based on Bank of Japan and Federal Reserve Board data.

Factors in Japanese Bank Investment in the United States

Being large does not necessarily imply a foreign presence. Some of the biggest U.S. banks have little activity overseas. To justify a move abroad a bank, like any other firm, has to meet two criteria. First, the good or service cannot be provided at comparable cost from its home base. Second, it must have some advantage not available to rivals based in the host country.[3]

Banking services, unlike manufactured products, fairly easily fulfill the first criterion. Banks prefer to be physically close to markets of interest to clients, whether existing or potential. This traditionally has implied a widely dispersed network of offices. With new communications technologies, however, an increasing number of activities can be conducted over long distances. That has led many banks to consolidate their worldwide operations in fewer locations, although the steady rise in Japanese branch offices abroad from 127 to 272 during the 1980s ran counter to this trend.

The second criterion -- that the disadvantages of a foreign-based bank extension be offset by some advantage over local rivals -- is far less obvious. Clearly, foreign entrants face some formidable obstacles. Banking regulations, for example, differ dramatically from country to country, putting a foreign competitor at a disadvantage even if local laws do not discriminate against outsiders. In addition, the technological infrastructure differs around the world; automated teller machine networks as sophisticated as those in the United States and Japan would be unthinkable in many countries. A bank accustomed to providing services in this way has to come up with alternatives in markets where ATMs do not exist. Moreover, language and customs loom large in an activity as people-oriented as retail banking. In fact, a few of today's large U.S. banks got their start as small banks catering to immigrant communities that felt uncomfortable with existing U.S. institutions. While language and cultural differences may create niches for overseas banks in the U.S. market, the same factors tend to confine foreign banks to those niches.

If banks have a real, albeit diminishing, need for foreign branches and face real disadvantages in establishing such a presence, then the increased

[3]This discussion follows closely an argument associated with Richard Caves of Harvard University, although Mr. Caves primarily discusses manufacturing. See Richard E. Caves, "International Trade, International Investment, and Imperfect Markets," Special Papers in International Economics, No. 10, 1974, pp. 17-26. For an application of Cave's model to Japanese banks in the United States, see Henry Terrell, "U.S. Banks in Japan and Japanese Banks in the United States: An Empirical Comparison," Quarterly Review of the Federal Reserve Bank of San Francisco, Summer 1979.

level of foreign -- especially Japanese -- banking activity in this country has to be based on significant, and growing, incentives. While some analysts see a cost-of-funds advantage for Japanese banks operating in the United States, others identify a strong pull from linkages with trade and investment activities.

Cost of Funds - Many American analysts believe Japanese banks can raise funds very inexpensively at home, where interest rates on deposits are more controlled than in this country. Japanese banks then can transfer these funds to their U.S. offices where they become weapons in capturing market share from American banks. This argument also suggests that when Japanese banks lend funds at what look like ridiculously low margins they are acting as if they were protected from failure by their government.

An American seeking a home mortgage, especially in California where Japanese banks are most active in the consumer market, might be tempted to applaud this apparent foreign aid, which benefits his or her personal aspirations for a home. However, the argument has limited validity. A large part of Japanese bank lending is funded from sources in the United States. Unpublished Federal Reserve Board data for December 31, 1988 indicated that 63 percent of the liabilities (funding sources) for U.S. agencies and branches of Japanese banks was from U.S. sources. The remaining 37 percent came from sources in Japan and elsewhere.

In fact, U.S. branches of Japanese banks even lend to the home office. Henry Terrell, Robert Dohner and Barbara Lowrey have found that deposits grew more slowly than loans in Japan between 1980 and 1988, with considerable year-to-year fluctuation in each. During periods when loans exceeded deposits by more than average amounts, the U.S. assets of Japanese banks increased by a commensurate volume.[4] The same result held for the activities of Japanese banks in the United Kingdom. In a sense the U.S. affiliates of Japanese banks serve an important role as suppliers of funds to the Japanese market, the reverse of what the U.S. bankers' argument implies, although it is consistent with the chronic inflow of short-term capital into Japan reported in the country's balance of payments statistics. (For details of Japan's 1989 current account statistics, where this inflow came to $20.8 billion, see JEI Report No. 7B, February 16, 1990.)

Of course, funds move the other direction as well. To the extent that the flow from Japan finances U.S. activities and involves an exchange of currency, the lender faces the danger that the dollar will decline vis-a-vis the yen. Should this happen, the hypothetical American borrowing through a U.S. affiliate of a Japanese bank indirectly could return to the home office of the Japanese bank fewer yen than he or she borrowed. In other words, the yen-denominated return could well be negative in the face of the yen's appreciation. To avoid this possibility a Japanese lender to U.S. clients could purchase yen in the forward market. Only if the cost of such cover is less than the difference in interest rates between the United States and Japan will a U.S. investment clearly be in the Japanese investor's interest. However, during the 1980s such

[4]Henry S. Terrell, Robert S. Dohner and Barbara R. Lowrey, "The U.S. and U.K. Activities of Japanese Banks: 1980-1988," Board of Governors of the Federal Reserve System International Finance Discussion Paper No. 361, 1989, pp. 26-28.

covered differentials on market interest rates largely vanished. (For details, see JEI Report No. 16A, April 20, 1990 and the references cited therein.)

The interest rate differential argument still carries weight, however. For example, the Japanese bank could have periods when it has a surplus of particularly low-cost funds that carry less than market interest rates. In addition, Japanese banks could respond to interest rate differentials by increasing their lending in the United States, bearing the risk of the currency fluctuation as one of the costs of doing business. The Terrell, Dohner and Lowrey study found that Japanese banks do increase their lending activity in the United States during periods when the nominal market interest rate gap widens between the United States and Japan.[5] This suggests that the flow of bank funds to the United States may carry considerable currency risk.

Levels of Trade and Investment - Japan's expanding trade and investment have reached particularly high levels in California. Japanese banks also have stepped up their activity in this country, especially in that state. Many analysts have noticed the connection and concluded that trade flows have caused the increase in Japanese bank activity.[6]

Like their American counterparts, Japanese exporters are more used to dealing with banks from their homeland. As a result, when they require foreign exchange, letters of credit and other trade-related financial services for their increased exports and imports, they typically have turned to Japanese banks. These considerations suggest that foreign banks follow trade. However, American and Japanese firms looking for export opportunities in Eastern Europe are discovering that an increase in trade can be smoother if a familiar banking system already is in place, suggesting that banks can lead trade.

Trade, in turn, often leads to investment. Exports from Japan create a stake in the American market for Japanese companies. Once that stake becomes large enough, direct foreign investment is feasible; if trade restrictions loom, it becomes something of an imperative. As investment spreads, so does the incentive for banks to follow. For example, few regard as accidental the presence of Mitsui Taiyo Kobe Bank, Ltd., Sanwa Bank, Ltd. and Tokai Bank, Ltd. in Lexington, Kentucky, not normally considered a center of foreign banking activity. In nearby Georgetown sits a car assembly plant owned by Toyota Motor Corp., in which the three banks are the largest stockholders. In addition, Tokai Bank's home office is in Nagoya, not far from Toyota's world headquarters. Mitsui Taiyo Kobe Bank is the lead bank participant in the Mitsui keiretsu and is a member of that group's presidents' club, as is Toyota. (For more on keiretsu and presidents' clubs, see JEI Report No. 2A, January 12, 1990.) Although Mitsui Taiyo Kobe Bank's office in Lexington cannot conduct banking business, it does serve a valuable function in helping Toyota deal with the intricacies of American banking.

While the above example suggests that banking follows investment, sometimes the reverse is true. Dai-Ichi Kangyo Bank of California noted in its 1989

[5] Ibid.

[6] Ibid. See also Gary C. Zimmerman, "The Growing Presence of Japanese Banks in California," Federal Reserve Bank of California Economic Review, Summer 1989, pp. 4-7.

annual report that it played a key role in attracting Kobe Precision, Inc. to Hayward, California in 1988 after introducing its parent, Kobe Steel, Ltd., to various California communities during its search for a U.S. production site. Negotiations between DKB-California and the Industrial Development Authority of Alameda County resulted in the issuance of low-cost industrial revenue bonds backed by a guarantee from DKB, the parent of DKB-California.

The preceding examples are not meant to suggest that the trade-investment-banking pattern is one that only Japanese firms follow. American banks played a similiar role in the postwar expansion of U.S. multinationals. In addition, U.S.-owned banks have a good track record for courting Japanese investment. In some such cases the American bank had long-standing U.S.-Japan expertise stemming from trade ties developed earlier.

The conclusion to be drawn from these examples is that trade, direct investment and Japanese banks in the United States are closely linked, but the causation runs in every direction. Areas of the country that have high levels of trade with Japan, such as the Pacific Northwest (which is primarily an exporter to Japan), also have comparatively high levels of Japanese investment and Japanese banking operations. This conclusion suggests that regions that have been left largely outside direct U.S.-Japan trade, perhaps because of their inland location, have a special reason to encourage Japanese-owned banks to locate in their area if they are interested in attracting Japanese direct investment.

Size and Distribution of Japanese Banks in the United States

In short, Japanese banks have several important advantages that permit them to be profitable in the United States and to overcome the disadvantages typically associated with operations in this country. The positive factors generally have grown, with the result that Japanese-owned institutions steadily became more important in the United States during the 1980s. As of May 1990 total employment in this country's Japanese-owned banks came to at least 25,000, with Americans accounting for an overwhelming percentage of the total, according to JEI estimates.

Much of the growth of Japanese banks has come at the expense of banks headquartered in foreign countries other than Japan. As Tables 1 and 2 show, the expansion in foreign banking activity in the United States during the last half of the 1980s was almost entirely a result of the growth of Japanese banks. A comparison of the two tables shows that the shares of both non-Japanese and Japanese banks consistently have been higher for commercial and industrial lending than for total assets, which roughly corresponds to total lending.

By the end of 1989 Japanese banks in the United States were both the biggest and the fastest growing among the 10 foreign banks with the largest representation. The U.S. presence of Japan-based institutions grew 19 percent per year between 1980 and 1989 measured by assets; runner-up Italy experienced 16.9 percent annual growth over the same period. (In 1980 British banks had been second largest but by 1989 were in fourth place.) Japan's share of foreign bank assets in the United States went from 36.6 percent to 57 percent during this period.

These figures must be interpreted with caution. As noted earlier, judging relative size from asset levels can be misleading. Arguably, Japanese banks

Table 1: Share of Foreign Bank Assets in Total U.S. Bank Assets, 1985-89

(June 30 of each year)

	Japanese Banks	Other Foreign Banks	Total Foreign Banks
1985	7.0%	11.6%	18.6%
1986	7.9	10.5	18.4
1987	10.1	10.8	20.9
1988	11.2	10.6	21.8
1989	12.1	10.5	22.6

Source: Calculated from data in American Banker, various issues.

Table 2: Foreign Share of Total U.S. Commercial and Industrial Lending, 1986-89

(June 30 of each year)

	Japanese Banks	Other Foreign Banks	Total Foreign Banks
1986	8.9%	13.2%	22.1%
1987	11.0	13.8	24.8
1988	13.9	13.6	27.5
1989	16.0	12.5	28.5

Source: Calculated from data in American Banker, various issues.

in the United States engage in more asset-based activity than do either their American or foreign bank rivals, inflating their apparent size. In addition, banks have the option of booking some of their U.S. activity in foreign offices, thereby avoiding certain domestic regulations; if the banks of one country are more prone to do this than their counterparts in other nations, their relative size in the United States will be understated. Some European banks report to their stockholders and others much higher levels of U.S. assets than those filed with the Federal Reserve Board (the basis of the data in the tables). For example, Barclays Bank claimed 1988 U.S. assets of $25 billion but told the Fed it had only $7.8 billion. Skandinaviska Enskilda Banken, Sweden's largest bank, reported $336 million in U.S. assets to the Fed but $727 million to its stockholders, an amount that included assets booked at its Cayman Islands branch. According to some experts, the Ministry of Finance rides herd on Japanese banks harder than do European authorities, minimizing these discrepancies. If so, the position of Japanese banks in the United States relative to those of Europe may be overstated substantially.[7]

[7]This argument follows closely one made by James Alexander, "Muscle or Mirage?" The Banker, March 1990, pp. 33-34.

No data are available to solve this puzzle completely. However, using additional Fed figures on lending to nonfinancial firms from banks and nonbanks located outside the United States, Herbert L. Bauer of the Federal Reserve Bank of Chicago estimated the share of commercial and industrial lending accounted for by foreign firms to be 28.3 percent in 1988, higher than the 20.7 percent figure he calculated for just U.S.-situated foreign banks. No breakout by country is available, but even if none of the increment was added by Japanese banks, they still would be left with the largest share of such foreign bank lending in the United States.[8]

In short, Mr. Bauer's results are consistent with ascribing a large role to Japanese banks in the United States. Like other foreign banks, they may play that role using one of several organizational forms. Branches and agencies, while restricted in the kinds of business they can conduct, are comparatively unregulated by U.S. authorities; conversely, Japanese regulatory agencies wield considerable authority over these types of operations. Branches and agencies rarely offer services to individuals -- in part because such business would require them to have insurance with the Federal Deposit Insurance Corp. But they are important in international transactions. Subsidiaries play a reverse role. They often offer services to individual Americans. Moreover, they are considered U.S. banks for many purposes and are required to have FDIC insurance; in addition, subsidiaries are firmly under the thumb of federal, and sometimes state, regulatory authorities. Generally, data are far more complete about subsidiaries since they have greater U.S. reporting requirements.

Subsidiaries, agencies and branches differ dramatically in importance by state. In California, for example, subsidiaries are important (see Table 3).

Table 3: Distribution of Assets of Japanese Banks by State, December 31, 1989

(in millions of dollars)

	Agencies	Branches	Subsidiaries	Other	Total
New York	$448	$258,883	$23,368	$158	$282,857
California	50,421	12,505	36,097	22	99,045
Illinois	0	30,584	0	0	30,584
Oregon	0	2,424	0	0	2,424
Texas	1,906	0	0	7	1,913
Georgia	1,550	0	0	0	1,550
Washington	0	1,471	0	0	1,471
Massachusetts	0	369	0	0	369
Florida	298	0	0	66	364
Hawaii	167	0	0	0	167
Total	54,791	306,237	59,465	252	420,746

Source: Federal Reserve Board, unpublished data.

[8]Herbert L. Bauer, "Foreign Competition in U.S. Banking Markets," Economic Perspectives, May/June 1990, p. 23.

After Congress passed the 1978 International Banking Act Japanese and other foreign banks were required to choose a "home away from home" -- a single U.S. state where they could operate a subsidiary. A handful of banks, including Bank of Tokyo, Ltd., were granted exceptions because they already operated subsidiaries in more than one state. Not surprisingly, many Japanese banks opted for California; the remainder chose New York. This suggests that Japanese banks currently would face a substantial legal barrier in expanding their retail banking services beyond New York and California. (One Japanese-owned bank, Bank of California (a unit of Bancal Tri-State Corp.), operates a few offices in Washington and Oregon under a separate grandfather clause granted the bank before it was sold to Mitsubishi Bank, Ltd. in 1984,)

The data also show that a handful of locations dominate activity. Outside California Japanese banks are found only in medium to large cities, but even relatively large cities, such as Indianapolis, Indiana and Milwaukee, Wisconsin, have no Japanese banks at all. In sparsely populated areas Japanese banks are completely absent. Across the northern tier of states, for example, there is no Japanese-owned bank presence between Minneapolis, Minnesota and Bellevue, Washington, just outside Seattle.

Comparisons with 1980 Federal Reserve Board figures show that some states have attracted much more interest in recent years. For example, Texas virtually prohibited Japanese banks until 1985, when it permitted agencies. As a result rapid growth has occurred in recent years. Georgia, Massachusetts and Florida had no Japanese banking activity at all in 1980. Illinois' position as the third most active location is a relatively recent development; in 1980 Washington and Oregon collectively were more important.

The absence of Japanese banks from much of the country does not mean they are totally unrepresented there. Japanese and other banks also operate representative offices, which have no legal authority to conduct banking business. (The offices of Mitsui Taiyo Kobe Bank, Sanwa Bank and Tokai Bank in Lexington, Kentucky are representative offices.) Such offices do, however, make referrals to other banks and serve as listening posts in sensitive locations, such as Washington, D.C. Table 4 provides a state-by-state breakdown of agencies, branches and representative offices operated by Japanese banks.

Japanese banks also own nonbank entities that may operate nationwide. For example, Fuji Bank's Heller International Corp. makes asset-based loans across the country. Some of these nonbank activities are described below.

Some U.S. subsidiaries of Japanese banks maintain offices abroad. For example, both Union Bank, a Bank of Tokyo subsidiary, and Bancal Tri-State (Bank of California) operate representative offices in Tokyo. In late May Fuji Bank and Mitsubishi Bank were reported in the Japanese press as planning to use Heller and Bank of California, respectively, as a means of expanding their presence in Southeast Asia, thereby largely circumventing the difficult Ministry of Finance regulatory process concerning such activity.

As measured by U.S. assets, Japanese banks have reached a size where they rival U.S. banks in this market. Table 5 shows that the Bank of Tokyo, including its subsidiaries in California and New York, was the largest Japanese bank in the United States as of December 31, 1989. Were BOT's $47 billion of U.S. assets held by a separate U.S. bank holding company, it would rank easily

Table 4: Japanese Bank Offices by State and City, June 30, 1989

	Agencies	Branches	Subsidiaries	Other	Representative Offices	Total
California						
Los Angeles	19	5	4	0	1	29
San Francisco	4	1	4	2	4	15
Total	23	6	8	2	5	44
District of Columbia	0	0	0	0	2	2
Florida						
Coral Gables	1	0	0	0	0	1
Miami	0	0	0	1	1	2
Total	1	0	0	1	1	3
Georgia (Atlanta)	4	0	0	0	9	13
Hawaii (Honolulu)	1	0	0	0	0	1
Illinois (Chicago)	0	14	0	0	8	22
Kentucky (Lexington)	0	0	0	0	3	3
Massachusetts (Boston)	0	1	0	0	0	1
Michigan (Southfield)	0	0	0	0	1	1
New York (New York)	1	38	17	2	20	78
Ohio						
Cleveland	0	0	0	0	1	1
Columbus	0	0	0	0	1	1
Total	0	0	0	0	2	2
Oregon (Portland)	0	1	0	0	1	2
Texas						
Dallas	1	0	0	0	2	3
Houston	3	0	0	1	12	16
Total	4	0	0	1	14	19
Washington (Seattle)	0	3	0	0	4	7
Total	34	63	25	6	70	198

Notes: Excludes offices of Bank of Japan, Japan Development Bank and Export-Import Bank of Japan.

Each subsidiary may have two or more retail branches. A handful of such subsidiary banks have branch networks of several dozen retail branches each and at least two networks have over 100 retail branches.

In September 1989 Daiwa Bank, Ltd. and Lloyds Bank PLC reached agreement for Daiwa to acquire 15 branches, agencies and representative offices of Lloyds. Legal closing occurred March 1, 1990. The above list does not reflect this transaction. The facilities are in Boston, Hartford, New York City, Philadelphia, Baltimore, Atlanta, Tampa, Miami, Pittsburgh, Chicago, St. Louis, Minneapolis, Dallas, Los Angeles and San Francisco.

Source: American Banker, annual reports and telephone inquiries of Japanese-owned banks and subsidiaries

among the 20 largest U.S. bank companies, about the size of First Chicago Corp. and Wells Fargo & Co.

Table 5 reflects several changes in recent years. Bank of Tokyo added about $8.3 billion in 1988 yearend assets with its acquisition of Union Bank and regained the top U.S. spot from Mitsubishi Bank, which had been larger in JEI's previous survey of Japanese banks in the United States based on June 30, 1987 data (see JEI Report No. 3A, January 22, 1988). (BOT merged its existing

Table 5: Japanese Bank Groups in the United States Ranked by Assets, December 31, 1989

(in thousands of dollars)

	Agencies	Branches	Subsidiaries	Other	Total
Bank of Tokyo, Ltd.	$3,076,752	$22,320,747	$21,758,155	$6,531	$47,162,185
Mitsubishi Bank, Ltd.	507,757	31,567,873	7,234,207	154,054	39,463,891
Dai-Ichi Kangyo Bank, Ltd.	5,308,959	31,456,001	530,986	--	37,295,946
Fuji Bank, Ltd.	5,395,240	26,084,280	3,679,027	10,223	35,168,770
Sanwa Bank, Ltd.	1,381,694	24,296,035	6,128,673	--	31,806,402
Industrial Bank of Japan, Ltd.	6,308,816	14,158,460	8,221,896	81,569	28,770,741
Sumitomo Bank, Ltd.	1,262,769	21,056,046	4,400,655	--	26,719,470
Tokai Bank, Ltd.	5,035,817	12,630,701	1,127,179	--	18,793,697
Mitsui Bank, Ltd.	2,020,920	15,344,688	1,346,558	--	18,712,166
Mitsui Trust & Banking Co., Ltd.	3,795,171	9,825,696	252,922	--	13,873,789
Mitsubishi Trust & Banking Corp.	2,841,196	10,058,911	441,371	--	13,341,478
Long-Term Credit Bank of Japan, Ltd.	2,879,633	9,045,905	992,370	--	12,917,908
Daiwa Bank, Ltd.	1,844,851	8,066,773	2,318,116	--	12,229,740
Sumitomo Trust & Banking Co., Ltd.	1,851,184	8,934,199	586,778	--	11,372,161
Yasuda Trust & Banking Co., Ltd.	3,605,937	5,856,971	228,251	--	9,691,159
Taiyo Kobe Bank, Ltd.	1,193,343	8,419,946	51,516	--	9,664,805
Nippon Credit Bank, Ltd.	1,999,230	5,357,808	--	--	7,357,038
Kyowa Bank, Ltd.	1,355,214	3,776,524	108,231	--	5,239,969
Toyo Trust & Banking Co., Ltd.	1,263,827	3,750,797	58,245	--	5,072,869
Saitama Bank, Ltd.	--	4,948,320	--	--	4,948,320
Hokkaido Takushoku Bank, Ltd.	697,470	3,407,361	--	--	4,104,831
Norinchukin Bank, Ltd.	--	3,944,157	--	--	3,944,157
Chiba Bank, Ltd.	--	3,301,854	--	--	3,301,854
Joyo Bank, Ltd.	--	2,735,378	--	--	2,735,378
Chuo Trust & Banking Co., Ltd.	474,734	2,218,703	--	--	2,693,437
Bank of Yokohama, Ltd.	241,890	1,900,471	--	--	2,142,361
Shizuoka Bank, Ltd.	448,372	1,157,693	--	--	1,606,065
Hokuriku Bank, Ltd.	--	1,481,142	--	--	1,481,142
Hiroshima Bank, Ltd.	--	1,436,656	--	--	1,436,656
Shoko Chukin Bank, Ltd.	--	1,349,139	--	--	1,349,139
Zenshinren Bank, Ltd.	--	1,225,880	--	--	1,225,880
Hyakujushi Bank, Ltd.	--	1,077,485	--	--	1,077,485
Hachijuni Bank, Ltd.	--	886,485	--	--	886,485
Bank of Fukuoka, Ltd.	--	671,827	--	--	671,827
Bank of Kyoto, Ltd.	--	600,979	--	--	600,979
Hokkaido Bank, Ltd.	--	551,986	--	--	551,986
Gunma Bank, Ltd.	--	539,489	--	--	539,489
Ashikaga Bank, Ltd.	--	418,286	--	--	418,286
Suruga Bank, Ltd.	--	223,110	--	--	223,110
Iyo Bank, Ltd.	--	137,416	--	--	137,416
Tokyo Tomin Bank, Ltd.	--	15,100	--	--	15,100
Total	54,790,776	306,237,278	59,465,136	252,377	420,745,567

Source: Federal Reserve Board, unpublished data.

California First subsidiary with Union Bank and adopted the name of the acquired institution for the new entity.)

The list also grew. For example, Tokyo Tomin Bank, Ltd. upgraded its New York representative office to branch status late in 1989. Like Tokyo Tomin, most of the institutions at the bottom of the list are regional banks that have opened a branch in New York in recent years.

Table 6 shows the bank subsidiaries of Japanese banks. As noted earlier, all are either in New York or California. The New York subsidiaries often specialize in trust business, while the California banks are more likely to offer a broad range of retail banking services, including checking accounts and credit cards. The subsidiaries of Japanese banks occupy four of the top 10 positions among California banks, as measured by assets, although they are

Table 6: Subsidiaries of Japanese Banks in the United States Ranked by Assets, December 31, 1989

(in thousands of dollars)

Subsidiary	Parent	State	Assets
Union Bank	Bank of Tokyo, Ltd.	California	$15,220,764
Bank of California	Mitsubishi Bank, Ltd.	California	7,234,207
Bank of Tokyo Trust Co.	Bank of Tokyo, Ltd.	New York	6,537,391
Sanwa Bank California	Sanwa Bank, Ltd.	California	6,128,673
Industrial Bank of Japan Trust Co.	Industrial Bank of Japan, Ltd.	New York	5,575,034
Sumitomo Bank of California	Sumitomo Bank, Ltd.	California	4,400,655
Fuji Bank & Trust Co.	Fuji Bank, Ltd.	New York	3,679,027
IBJ Schroder Bank & Trust Co.	Industrial Bank of Japan, Ltd.	New York	2,646,862
Daiwa Bank Trust Co.	Daiwa Bank, Ltd.	New York	2,318,116
Mitsui Manufacturers Bank	Mitsui Bank, Ltd.	California	1,346,558
Tokai Bank of California	Tokai Bank, Ltd.	California	1,127,179
LTCB Trust Co.	Long-Term Credit Bank of Japan, Ltd.	New York	992,370
Sumitomo Trust and Banking Co. USA	Sumitomo Trust & Banking Co, Ltd.	New York	586,778
Dai-Ichi Kangyo Bank of California	Dai-Ichi Kangyo Bank, Ltd.	California	530,986
Mitsubishi Trust & Banking Corp. (U.S.A.)	Mitsubishi Trust & Banking Corp.	New York	441,371
Mitsui Trust Bank U.S.A.	Mitsui Trust & Banking Co., Ltd	New York	252,922
Yasuda Bank and Trust Co. USA	Yasuda Trust & Banking Co, Ltd.	New York	228,251
Kyowa Bank of California	Kyowa Bank, Ltd.	California	108,231
Toyo Trust Company New York	Toyo Trust & Banking Co., Ltd.	New York	58,245
Taiyo Kobe Bank & Trust Co.	Taiyo Kobe Bank, Ltd.	New York	51,516
Dai-Ichi Kangyo Trust Co. of New York	Dai-Ichi Kangyo Bank, Ltd.	New York	n.a.
Mitsubishi Bank and Trust Co.	Mitsubishi Bank, Ltd.	New York	n.a.
Mitsui Finance Trust Co.	Mitsui Bank, Ltd.	New York	n.a.
Sumitomo Bank New York Trust Co.	Sumitomo Bank, Ltd.	New York	n.a.
Tokai Trust Co.	Tokai Bank, Ltd.	New York	n.a.
Total			59,465,136

Source: Federal Reserve Board, unpublished data.

dwarfed by the four largest banks in the state -- Bank of America NT&SA, Security Pacific National Bank, Wells Fargo Bank NA and First Interstate Bank of California. Nor do the Japanese subsidiaries have extensive retail operations in other Pacific states as do rivals Bank of America, Security Pacific and

First Interstate. They do have access, however, to the worldwide resources of their parents, including the branches and agencies of the parents in California.

In sum, Japanese banks unquestionably are a major force in the American banking market, although the official data may overstate their dominance over other foreign banks. Their mere size alone, however, suggests relatively little about what they do. It is that subject that the next section addresses.

What Japanese Banks Do in the United States

Japanese banks are particularly active in international trade finance in America. This activity can take the form of financing imports from Japan or, increasingly, exports to Japan. Other lending is in connection with direct investment that involves a Japanese firm, often with an American partner. For example, Mitsubishi Bank along with Morgan Guaranty Bank, took the lead in 1988 in arranging complex financing -- ultimately about $500 million worth -- for the Mitsubishi Motors Corp.-Chrysler Corp. joint venture in Illinois that produces cars for both companies. Similarly, in 1988 Sanwa Bank lent $55 million to Wheeling-Nisshin Inc., a joint venture of Nisshin Steel Co., Ltd. and Wheeling-Pittsburgh Steel Corp. that operates a steel coating plant in Follansbee, West Virginia.

On the face of it, such traditional banking usually is an easy business: the bank merely takes an individual's or a firm's money and lends it to someone else, covering expenses and making a profit on the difference between the relatively high lending rate and the lower rate paid on savings. However, in recent years in Japan and elsewhere new rivals have cropped up, perhaps because the business is so straightforward. In addition, large corporations increasingly raise their own funds. As a result, banks have had to narrow their margins to compete for the remaining business, and the activity has lost some of its appeal. Another response has been for banks to seek new opportunities from the fairly short menu of choices offered them by regulatory authorities.

These choices have been particularly constricted in Japan. Even though Washington has been less accommodating than several European governments, the size of the U.S. market and its extensive trading and investment relations with Japan have made this country attractive for Japanese banks, which try out innovations, some of which would be difficult or impossible to implement at home.

The most obvious option is to move into new kinds of lending. Both American and Japanese banks increasingly have emphasized lending to medium-sized firms in the United States. (Definitions vary, but one widely used criterion describes these firms as having between $10 and $250 million in revenues per year.) Many Japanese acquisitions in the 1980s clearly had the objective of moving Japanese banks into the middle market. In 1981 Mitsui Bank, Ltd., a predecessor to Mitsui Taiyo Kobe Bank, purchased Manufacturers Bank, a California lender to such firms. In 1984 Fuji Bank bought Heller International, which has a similar middle-market focus. Analysts interpreted Bank of Tokyo's 1988 purchase of Union Bank from Standard Chartered PLC as an effort to strengthen the relatively weak position in that niche of BOT's existing California subsidiary, California First.

This area of interest continues. In September 1989 two Japanese banks announced initiatives that analysts interpreted as indicative of interest in

the middle market. Dai-Ichi Kangyo Bank purchased 60 percent of CIT Group, a finance company that specializes in lending and leasing to medium-sized firms, from Manufacturers Hanover Corp. (As part of the deal DKB also acquired a small share of Manny Hanny itself.) In addition, Daiwa Bank, Ltd. purchased 15 American branches and representative offices owned by Lloyds Bank PLC, the British giant, in a move that was thought to position Daiwa for lending to the same segment of the overall market.

While Japanese banks have shown more interest in relatively small American businesses than they had previously, they also increasingly have been involved in deals that restructure U.S. corporate giants. For example, Japanese bankers were engaged on both sides of the 1988 takeover battle for Federated Stores Inc. between R.H. Macy & Co. and eventual winner Campeau Corp. Although Japanese banks sold much of their commitment to others, including a number of relatively small Japanese financial institutions, when Campeau declared bankruptcy in January most of those that had been involved faced substantial losses. Some estimates put the Japanese bank share of overall American LBO lending as high as 25 percent, which compares with a U.S. bank share of 52.6 percent. (For details of the role of Japanese banks in recent U.S. corporate restructuring activity, see JEI Report No. 41B, October 27, 1989.)

In many situations the activities of Japanese banks, like those of their American counterparts, are not reflected as assets on the books. In this way the banks potentially are able to increase their profits without increasing their assets, making it easier for them to fulfill international capital/asset requirements that loom in 1992. For example, Japanese banks have increased their foreign exchange operations in this country; Dai-Ichi Kangyo Bank and Fuji Bank each announced in early 1990 that it would at least double its staff of foreign exchange traders in New York. Even with the additions both banks' currency trading staffs would be a fraction of the size of such U.S. multinational banks as Bankers Trust, which often earn as much as several hundred million dollars each year from trading.

Similarly, Japanese banks are getting more involved in swaps, a transaction where a bank typically collects a fee for switching the currency and interest rate terms among two or more securities, often to the benefit of each of the security issuers. Since the securities do not necessarily become bank assets, the capital adequacy ratio is not imperiled. Japanese banks also are active in the arcane world of standby letters of credit, essentially guarantees that a firm raising money by issuing securities will make payments. In return for this "insurance," the bank collects a fee. While information about this market is sketchy, Japanese banks reportedly held 44 percent of the California market in 1988.[9]

The Future: New Problems?

Letters of credit may not be a household term, but the concept is understood at least vaguely on Capitol Hill. In May of this year Rep. Frank Annunzio (D, Ill.), the chairman of the House Banking subcommittee on financial institutions, shot off letters to Treasury Secretary Nicholas Brady and Commerce Secretary Robert Mosbacher complaining that "in the letter-of-credit market for municipal securities in the United States, the Japanese dominate the market and

[9]Zimmerman, op. cit., p. 9.

have driven out domestic banks almost completely."[10] Mr. Annunzio cited letters of credit as an example of where he suspected that financial services "dumping" could be occurring. He urged Messrs. Mosbacher and Brady to discuss such problems in multilateral trade talks on services, such as those that form part of the Uruguay Round of the General Agreement on Tariffs and Trade.

Mr. Annunzio's use of the term "dumping" obviously was important, especially since he used the statutory definition of the word. Under this concept merely undercutting the price of a rival or driving competitors out of a market is not sufficient to prove dumping, which depends on injury as well as both price and cost considerations. Since firms found guilty of dumping can be assessed penalties, Mr. Annunzio was raising the specter of retaliation against Japanese banks for their pricing of products in the United States. Of course, many municipal governments have benefited from low rates for letters of credit and the willingness of Japanese banks to lend and would rather that Congress expand the powers of domestic banks than permit restriction of foreign banks.[11]

Mr. Annunzio soon may have an opportunity to address a related question. A measure that could, if enacted, limit the activities of Japanese banks in this country cleared the Senate Banking Committee in late May. Sen. Donald Riegle (D, Mich.) and Sen. Jake Garn (R, Utah), the committee's chairman and ranking Republican, respectively, have cosponsored the Fair Trade in Financial Services Act, which would establish a procedure for denying permission to establish or expand operations to financial institutions from countries that do not open their markets to comparable U.S. firms, mainly banks and securities companies. Given the current anxieties on Capitol Hill and the apparent dominance of Japanese institutions among foreign banks in the United States, few doubt that Japan was the target. Most remaining uncertainty evaporated when the Senate panel accepted an amendment submitted by Sen. Christopher Dodd (D, Conn.) that was interpreted as exempting financial firms from the European Community. Among the 10 countries with the largest foreign bank presence in this country the measure apparently could affect only Japan, Canada, Hong Kong, Switzerland and Israel. Prospects for passage in the Senate are considered fairly good, less so in the House. The Bush administration testified vigorously against the bill, but some Hill watchers believe the White House could change its mind.

The Riegle measure, in essence, calls for what is known as "reciprocal national treatment." The United States under this doctrine would treat foreign financial institutions the same as domestic ones ("national treatment") only if U.S. institutions also get national treatment in other countries. The 1978 International Banking Act established national treatment -- without the reciprocity provision -- as the guiding principle of U.S. international banking policy.

[10]Letter from Frank Annunzio to Robert Mosbacher dated May 15, 1990, released by Rep. Annunzio's office.

[11]For example, see the testimony of Kenneth B. Dobson, executive vice president of the Detroit (Michigan) Downtown Development Authority, before the Committee on Banking, Finance and Urban Affairs' subcommittee on financial institutions supervision, regulation and insurance, "Oversight Hearing on Foreign Competition in the Banking Industry," May 14, 1990.

However, the 1988 trade act introduced the concept of reciprocal national treatment for primary security dealers. Pursuant to that law the Federal Reserve Board reviewed the treatment U.S. firms receive in Japan and elsewhere and decided in August 1989 against taking action against any foreign-controlled primary dealers in this country. (Japanese banks are among the foreign financial institutions that control primary dealers in U.S. government securities. For details, see JEI Report No. 34B, September 1, 1989.) The Fed, however, promised to revisit the issue. The Riegle measure, if enacted, would cover much more financial activity.

This spring the Fed signaled a readiness to take a tougher approach toward Japanese banks. Along with the Comptroller of the Currency, one of the agencies with which it shares regulatory responsibility over the nation's banking system, the Fed reportedly indicated a change in U.S. requirements as they apply to the branches of Japanese banks in this country that lend to loss-ridden American subsidiaries of Japanese firms. Either the parent of the borrowing firm will have to provide guarantees or else the bank will be required to maintain bad-debt reserves on a branch-by-branch basis. Japanese banks find the measure unusual, especially the close supervision of branch activities, and feel that compliance would raise management difficulties. Nihon Keizai Shimbun, Japan's top economic daily, made it the lead story on the day the news broke.

Not only do Japanese banks have to scramble to keep up with U.S. regulatory authorities and proposed U.S. legislation, but they face domestic problems that could affect their international activities. For fiscal 1989, which ended March 31, most large banks posted a rare decline in profits. The Bank for International Settlements' guidelines on capital adequacy call for Japanese banks to have total capital of at least 8 percent of assets by 1992. Lower profits, along with greater difficulty in selling new stock issues as a result of the weak Tokyo stock market earlier this year, have made additions to capital more difficult in the first half of 1990. Therefore, restraining the growth of assets has become a major part of the strategy for achieving this ratio. For this reason and because of the increased attention paid to the questions of Japanese banks in the United States, banks in Japan reportedly plan single-digit annual percentage increases in assets over the next several years at their U.S. operations. This means that lending will be relatively restrained; it also may mean increased efforts to build short-term profits.

Conclusion

These recent developments suggest that the expansion of Japanese banks in the United States may have peaked. In coming years, however, Japanese banks will become more important in this country across a wide range of financial services, especially those that do not put assets on the books. Much, of course, will depend on legislative developments in the United States and Japan. Substantial revision of the Glass-Steagall Act, the law that prohibits commercial and investment banks from entering each other's businesses, would open new opportunities for Japanese banks -- particularly long-term credit banks, such as Industrial Bank of Japan, Ltd. Some observers also feel that changing Glass-Steagall would have an even greater effect in reinvigorating U.S. financial firms vis-a-vis their Japanese and other foreign rivals.

Moreover, Japanese and other banks will get additional options as interstate banking continues to spread in the United States. On January 1, 1991

California will become the latest state to permit interstate banking on a reciprocal basis. As a result, banks from California -- including the subsidiaries of Japanese banks -- will be able to establish retail operations in virtually all states in return for the right of banks from the same states to set up affiliates in California. To date, the main activity of Japanese banks in this regard has been to shore up their California bases in anticipation of an expected invasion from East Coast banks. How the presence of Japanese banks in this country will play in Peoria when Japanese banks get the right to operate retail affiliates in that Illinois city remains to be seen.

For further information, contact Douglas Ostrom.

Ian Condry provided research assistance.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.